United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

75-1108

To be argued by
ROBERT S. PERSKY

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UNITED STATES COURT OF APPEALS

for the

SECOND CIRCUIT

UNITED STATES OF AMERICA,

Plaintiff-Appellee,

-against-

ROBERT S. PERSKY,

Defendant-Appellant.

ON APPEAL FROM JUDGMENT AND COMMITMENT OF
THE UNITED STATES DISTRICT COURT FOR
THE SOUTHERN DISTRICT OF NEW YORK

DEFENDANT-APPELLANT ROBERT S. PERSKY'S BRIEF

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TABLE OF CONTENTS

Cases Cited

Texts

Statutes Cited

Page

Title 15, U.S.C. §§ 78j; 78ff(a) and Reg. 240.10b-5

§ 78j. Manipulative and Deceptive Devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange--

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

June 6, 1934, c. 404, § 10,48 Stat. 891.

Reg. § 240.10b-5. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

§ 78ff

(a) Any person who willfully violates any provision of this chapter, or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this chapter, or any person who willfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed under this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78o of this title, which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than $10,000, or imprisoned not more than two years, or both, except that when such person is an exchange, a fine not exceeding $500,000 may be imposed; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

UNITED STATES OF AMERICA,	
Plaintiff-Appellee,	
-against-	
ROBERT S. PERSKY,	
Defendant-Appellant.	

DEFENDANT-APPELLANT ROBERT S. PERSKY'S BRIEF

Preliminary Statement

This is an appeal from the denial of motion for (i) a directed verdict of acquittal, (ii) an order in arrest of judgment, (iii) a new trial and (iv) a judgment of conviction entered against appellant, after a jury verdict of guilty on one count charging him with fraud in connection with the purchase and sale of the securities of a corporation by the name of Microthermal Applications, Inc. ("Microthermal").

The trial involved an additional count charging failure to file a Form 8K for Microthermal. That count was dismissed at the conclusion of the government's case.

ISSUES PRESENTED

1. ARE SECTION 10(b) OF THE EXCHANGE ACT AND RULE 10b-5 TOO UNCERTAIN AND INDEFINITE TO BE PENAL STATUTES?

2. WAS THE COURT'S INSTRUCTION TO THE JURY IN RELATION TO SECTION 10(b) AND RULE 10b-5 ERRONEOUS IN THAT IT WAS TOO BROAD?

3. DID THE GOVERNMENT PROVE ANY PURCHASE OR SALE IN CONNECTION WITH DEFENDANT'S ALLEGED FRAUD?

STATEMENT OF THE CASE

For the purposes of this appeal, Defendant Robert S. Persky, accepts the government's version of the facts set forth in Count Four of the indictment (A-18-22). In summary, the government alleged and introduced evidence that Defendant, along with others, attempted to cover up the theft by John Galanis and Akiyoshi Yamada of $500,000 from Microthermal.

The means by which the coverup was effected was, according to the indictment, first a merger of Microthermal with a company known as Meridian Capital Corporation ("Meridian"), second the acquisition of the securities of a company known as U.S. Secretarial Institute, Ltd. ("Secretarial") by Microthermal and finally by the transfer of the control of Microthermal to the principals of a company known as Continental Engineering & Development, Inc. ("Continental"). By the time the events alleged in Count Four occurred, the government conceded that the misappropriated funds had been reduced by payments back to Microthermal by the sum of $375,000.

The evidence introduced by the government at trial is not an issue on this appeal except insofar as it relates to the very limited issue of whether or not even under the trial court's broad instructions to the jury (See Point II) there was a

failure of proof of fraud "in connection with the purchase or sale of any security".

The government did not contend that Defendant or any other person or entity named in the indictment purchased or sold any of the securities of Microthermal during the period alleged in Count Four (July 1, 1970 through March 31, 1971) nor was there any suggestion that the transactions alleged in Count Four were designed to manipulate the market or the price of Microthermal securities.

POINT I

SECTION 10(b) OF THE EXCHANGE ACT AND RULE 10b-5 ARE TOO UNCERTAIN AND INDEFINITE TO BE PENAL STATUTES

As a general rule, crimes must be defined with appropriate certainty and definiteness. Pierce v. U.S., 314 U.S. 306, 62 S.Ct. 327, 86 L.Ed. 226 (1941), U.S. v. Butler, 204 F.Supp. 339 (S.D.N.Y. 1962).

The test applied in determining compliance with this requirement is whether the language conveys a sufficiently definite warning as to the proscribed conduct when measured by common understanding and practices. Cramp v. Board of Public Instruction, 368 U.S. 278, 82 S.Ct. 275, 7 L.Ed. 2d 285, (1961).

> "It is a well settled rule that, in the absence of an express statutory provision to the contrary, penal statutes are to be strictly construed in favor of the accused. By this it is meant that they are to be construed strictly in those parts which are against the accused, but liberally in those parts which are in his favor." [footnotes omitted] Clark and Marshall, A Treatise On The Law Of Crimes 46-7 (7th ed., 1967). See also, 3 Sutherland, Statutory Construction (3rd ed.) § 5604; McBoyle v. United States, 283 U.S. 25 (1931) [per Mr. Justice Holmes]; Lanzetta v. New Jersey, 306 U.S. 451 (1939); Connally v. General Construction Co., 269 U.S. 385, 391 (1926); Cline v. Frink Dairy Co., 274 U.S. 445 (1927); United States v. Reese, 92 U.S. 214 (1875).

Section 9.05 of Bloomenthal, Securities and Federal Corporate Law (Vol. 3A, 1972) states

> "Rule 10b-5 has undoubtedly outstripped the objectives Congress had in mind in enacting Section 10(b)." See also Ruder, Civil Liability under Rule 10b-5: Judicial Revision of Legislative Intent? Nw.U.L.Rev. 627 (1963)

Professor Bromberg comments at the start of his two volume text on Rule 10b-5,

> "A startling variety of everyday transactions have turned out to be 'fraudulent' under SEC Rule 10b-5...The Rule itself is... far simpler and more innocent looking than the interpretations given it." 1 Bromberg, Securities Law: Fraud p. 3. (1971)

The judicial and administrative interpretations of Section 10(b) and Rule 10b-5 which have spawned Professor Bromberg's two-volume text have extended and continue to extend the section and the rule to the point where their perimeters lack appropriate certainty and definiteness.

The applicable rule of law was stated by Mr. Justice Reed in Pierce, supra,

> "...judicial enlargement of a criminal act [statute] by interpretation is at war with a fundamental concept of the common law that crimes must be defined with appropriate definiteness. Cf. Lanzetta v. New Jersey, 306 U.S. 451, 83 L.ed. 888, 59 S.Ct. 618, and cases cited." p. 311

In U.S. v. Butler, supra, decided in this district, it was held that,

> "It is well established that a criminal statute must be definite as to the acts which it prohibits. See United States v. Cardiff, 344 U.S. 174, 73 S.Ct. 189, 97 L.Ed. 200 (1952)" p. 343

To suggest that Section 10(b) and Rule 10b-5 are definite as to the acts they prohibit is frivolous. A draftsman of the Exchange Act has characterized the catchall purpose of Section 10(b) as a commandment, "Thou shall not devise any other cunning devices." [Thomas G. Corcoran in "Hearings Before the House Committee on Interstate and Foreign Commerce." 73rd Cong., 2d Sess. 115 (1934)].

As to Rule 10b-5, Professor Bromberg asks,

> "What is this 'new' fraud?"

and answers himself,

> "No categorical answer is possible." 1 Bromberg, Securities Law: Fraud Sec. 1.1, p. 5 (1971)

In Cramp, supra Mr. Justice Stewart wrote,

> "We think this case demonstrably falls within the compass of those decisions of the Court which hold that '...a statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application, violates the first essential of due process of law.'" Connally v. General Constr. Co., 269 US 385, 391, 70 L.ed. 322, 328, 46 S.Ct. 126. "No one may be required at peril of life, liberty or property to speculate

> as to the meaning of penal statutes...Words which are vague and fluid...may be as much of a trap for the innocent as the ancient laws of Caligula." p. 287, 292

The government may argue [as it did earlier in these proceedings] that since there have been prosecutions under Section 10(b) and Rule 10b-5, Defendant's position that Section 10(b) and Rule 10b-5 are too vague to be penal statutes or the basis for criminal prosecution is "absurd".

The government's "absurdity" contention flies in the face of the actual difficulties the Federal Courts have had in interpreting what acts are proscribed by Section 10(b) and the learned texts cited earlier in this memorandum.

While it is true that the government can cite cases of prosecution under Section 10(b) and Rule 10b-5, in no case is there any indication that the question was raised as to whether Section 10(b) and Rule 10b-5 in themselves were too vague to be penal statutes or the basis for a criminal prosecution.

Nothing could be more demonstrative of the amorphous nature of 10b-5, even when coupled with alleged facts, than the colloquy which took place at the end of each of the first two days of trial between the Court and the United States Attorney (A-40 to A-62).

It was clear that the Court, quite properly, had great difficulty in ascertaining what conduct on the part of Defendant constituted a violation of 10b-5.

The appropriate certainty and definitiveness tests of Pierce and Butler, supra are not met by Section 10(b) and Rule 10b-5.

No statute or rule has proved more fluid or amorphous than Section 10(b) and Rule 10b-5 respectively, and they are too uncertain and indefinite to be penal statutes and Count Four should have been dismissed.

POINT II

THE COURT'S INSTRUCTIONS TO THE JURY IN RELATION TO SECTION 10(b) AND RULE 10b-5 WERE TOO BROAD

The government's version of the facts (which are accepted for purposes of this appeal) is that

(i) Microthermal's four hundred and eighty thousand ($480,000) dollars was converted by Galanis and Yamada prior to January 31, 1970.

(ii) Some of the converted funds were repaid and the balance due Microthermal in the fall of 1970 was approximately $375,000.

(iii) Defendant knew about the theft by Galanis and Yamada and participated in transactions designed to cover up the theft.

The government's position is that the coverup gave rise to a 10b-5 violation.

The pertinent language of Rule 10b-5 (17 CFR 240.10b-5) is:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange
>
> (1) to employ any device, scheme or artifice to defraud,

> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." [Emphasis added.]

The indictment alleges that the violation occurred in the purchase and sale of the shares of Microthermal (COUNT FOUR, paragraph 1). (A-18)

The bill of particulars referred to Microthermal's stock transfer records insofar as it identified purchases and sales "in connection with" the alleged fraud and at the trial the government introduced into evidence the transfer sheets of Microthermal for the period encompassing the spring of 1970 through March of 1971. (A-32)

The Continental Engineering transaction which did involve the issuance of Microthermal shares to Continental shareholders was not specified in the bill of particulars as being the sale or purchase "in connection with" the alleged fraud and the government's proof at trial was that the Continental shareholders expected nothing more than an "empty shell" and were told the U.S. Secretarial shares had "no value".

No evidence was introduced that the Defendant, Microthermal, or anyone named in Count FOUR purchased or sold any Microthermal shares between the spring of 1970 and March 1971.

No evidence was introduced that indicated an intent to manipulate the market price of the shares of Microthermal by anyone named in Count Four.

The Court's charge to the jury insofar as it related to the phrase "in connection with the purchase or sale of any security" which appears in both the statute and the rule was:

> "And the third essential element is that the defendant, Mr. Persky, engaged in this conduct in connection with the purchase or sale or both of shares of Micro.
>
> Now, the Government need not show that the defendant, Mr. Persky, or any of the others named, bought or sold themselves shares of Micro or participated in such transactions. It is sufficient if the Government shows that from the period between July 1, 1970, and March 31, 1971, there were purchases or sales or both of shares of Micro, and that the device or scheme employed or act or practice was of a sort that would cause reasonable investors to rely thereon, and in connection therewith so relied to purchase or sell shares of Micro." (T-1297-1298)

The government's version of the motive for the transactions (Meridian [not consummated], U.S. Secretarial and Continental Engineering) was that Defendant desired to conceal the theft of Microthermal's $375,000 by Galanis and Yamada.

In summary, the thrust of Count FOUR is that the U.S. Secretarial transaction was designed to conceal the theft of Microthermal's assets by Galanis and Yamada. There is no allegation nor was there proof at trial that, during the time span covered by any of the events alleged in Count FOUR:

(a) securities of Microthermal were being sold or purchased by Microthermal, or

(b) securities of Microthermal were being sold or purchased by Defendant Persky (or for that matter any defendant), or

(c) Defendant or anyone named in the indictment intended that the transactions influence the market or market price of Microthermal stock, or

(d) the transactions did in fact influence the market or the market price of Microthermal stock.

This Court has stated, in connection with Rule 10b-5

> "That the conduct averred in any given case may be reprehensible does not mean that a federal remedy must be furnished by judges. The remedy in many cases may be found in state courts..." Iroquois Industries Inc. v. Syracuse China Corp., 417 F.2d 963, 969 (2 Cir. 1969), cert. denied, 399 U.S. 909 (1970);

That holding was followed as recently as Molasky v. Garfinkle, 380 F.Supp. 549 (S.D.N.Y. 1974).

In Radiation Dynamics, Inc. v. Goldmuntz, 464 F.2d 876 (2d Cir. 1972) the rationale behind Rule 10b-5 was succinctly stated:

> "Rule 10b-5 was intended to prevent those in possession of material inside information from using that information to their own advantage when dealing with others not possessing the same information." 464 F.2d 887

Neither S.E.C. v. Texas Gulf Sulphur Company, 401 F.2d 833 (2d Cir. 1968) cert. denied 394 U.S. 976 (1969) nor Supt. of Insurance of the State of New York v. Bankers Life & Casualty Co., 404 U.S. 6 (1971) were criminal cases, and, in any event, the decisions in neither of those cases is as broad as the government suggested during the colloquy at trial.

In Bankers Life, the Court found that there was a sale of securities, to wit, the United States Treasury

Bonds involved therein. That sale was an integral part of the scheme complained of by plaintiff therein.

The thrust of Count FOUR is that the U.S. Secretarial transaction was designed to conceal the Galanis and Yamada theft.

The market purchases and sales of Microthermal by unrelated parties were at most random events "concurrent in time" but not "in connection with" the alleged fraud.

In Landy, et al. v. Federal Deposit Insurance Corporation, 486 F.2d 139 (3rd Cir., 1973), cert. den. 94 S.Ct. 1974, the Court carefully considered the extent to which Bankers Life extended Rule 10b-5.

In stating the facts of Bankers Life succinctly, the Court in Landy, supra, at page 154 said:

> "One of the defendants, Bankers Life and Casualty Co. agreed to sell all of Manhattan's stock to one Begole for five million dollars. The complaint alleged that Begole conspired with one Bourne and others to pay for the stock with Manhattan assets. They allegedly arranged, through Garvin Bantel & Co. a note brokerage firm, to obtain a five million dollar check from Irving Trust Co., although they had no funds on deposit there at the time. On the same day they purchased all the stock of Manhattan from Bankers Life for five million dollars..." [Emphasis supplied.]

The facts of Bankers Life are clearly distinguishable from the facts herein in that one integrated transaction occurring on the same day constituted the fraud alleged in

connection with the sale of a security. In Landy, supra, the Court at pages 160 and 161 said:

> "As we have already noted, Bankers Life expanded the coverage of Rule 10b-5 over fraud 'in connection with the purchase or sale of securities.' It was unnecessary, however, for the Court to give precise definition to the term 'in connection with' since the fraud there was directly related to the sale of the securities, depriving the corporation of the proceeds of the transaction. The pertinent question here is whether the brokers' alleged acts were 'in connection with' plaintiffs' purchase of ENB shares.
>
> "A scheme deliberately calculated to manipulate the market value of a stock would be covered under the rule. Crane Company v. Westinghouse Air Brake Company, 419 F.2d 787 (2d Cir. 1979); SEC v. North American Research & Development Corp., 280 F.Supp. 106 (S.D.N.Y. 1968). This follows easily from the language of the rule and from its purpose to protect investors. Annot. 3 ALR Fed. 819, 822. No such intent on the part of the brokers to manipulate ENB share prices, however, has been alleged in this case."

As in Landy, the government has failed to allege and prove an intent to manipulate Microthermal share prices.

In In re R. Hoe & Co., Inc., _F.Supp._ (S.D.N.Y. 1974), No. 69B461 HRT. May 2, 1974 Judge Tyler said

> "...the alleged fraud must be intrinsic to the securities transaction itself. Drackman v. Harvey, 453 F.2d 722, 732 (2d Cir. 1972); Iroquois Industries v. Syracuse China Corp. 417 F.2d 963 (2d Cir. 1969), cert. denied, 399 U.S. 909 (1970); Greenstein v. Paul, 400 F.2d 580 (2d Cir. 1968) (emphasis supplied).

Bankers Life, supra. was prior to Drackman, supra, is referred to therein and does not derogate from Iroquois Industries, supra. or Greenstein, supra. insofar as they

support the proposition that the fraud must be "intrinsic to the securities transaction."

Texas Gulf Sulphur, supra. involved the question of whether a civil injunction was an appropriate remedy to prevent continued circulation of false press releases (the injunction was ultimately denied). This Court also found that the individual defendants violated Rule 10b-5 in the stock transactions executed on their own behalf. (401 F.2d at 853).

That varying interpretative standards apply to the federal securities laws depending on the nature of the action and the particular facts involved therein cannot be seriously debated. Both the Supreme Court and this Circuit have recognized that what constitutes the elements of a cause of action for fraud under the federal securities laws, such as a violation framed under Rule 10b-5, may vary or differ depending on the nature of the relief sought in a particular lawsuit. Mr. Justice Goldberg, in S.E.C. v. Capital Gains Research Bureau, 375 U.S. 180, 193 (1963), in construing a fraud cause of action under Section 206 of the Investment Advisers Act of 1940, 15 U.S.C. 80b-6, a provision very similar to Rule 10b-5 under the 1934 Act, pointed out that the elements of a cause of action for "fraud" vary "with the nature of the relief sought",

and that "It is not necessary in a suit for equitable or prophylactic relief to establish all the elements required in a suit for money damages." See also, S.E.C. v. Texas Gulf Sulphur Co., 401 F.2d 833, 864-869 (C.A. 2, en banc, 1968) [concurring opinion of Judge Friendly]; Mutual Shares Corp. v. Genesco, Inc., 384 F.2d 540, 547 (C.A. 2, 1967). A fortiori proof of the elements sufficient to support civil injunctive relief would not necessarily support a criminal prosecution for a violation of the identical rule or statutory provision.

In 1950, the Supreme Court faced with a strikingly similar statutory framework rejected an effort by the Government to premise criminal prosecution upon construction afforded civil liability remedies. The Court in United States v. C.I.T. Universal Credit Corp., 344 U.S. 218, 221-222 (1952) declared:

> "[W]hen choice has to be made between two readings of what conduct Congress had made a crime, it is appropriate, before we choose the harsher alternative, to require that Congress should have spoken in language that is clear and definite. We should not derive criminal outlawry from some ambiguous implication." [Emphasis added.]

The trial court's instruction to the jury in relation to the "in connection with" clause was erroneous in that it was too broad.

POINT III

EVEN ACCEPTING THE COURT'S INSTRUCTION TO THE JURY THERE WAS A FAILURE OF PROOF OF A PURCHASE OR SALE IN CONNECTION WITH THE ALLEGED FRAUD.

The government relied on the testimony of five witnesses in an attempt to establish purchases or sales of Microthermal shares in connection with the alleged fraud.

An analysis of that testimony demonstrates that there was a failure of proof on the issue of purchases and sales, even if the trial court's broad instruction is accepted.

Robert D. Halsey (R 606-610) testified he purchased Microthermal shares at the time of the original public offering in July, 1969. [Count Four alleges unlawful conduct between July 1, 1970 and March 31, 1971] At the time of the trial in January, 1975, he still held the Microthermal shares. Halsey was neither a purchasernor seller during the critical time period.

Roger Bernhammer (R 728-738) testified that he was a vice president of Microthermal's transfer agent and laid the foundation for the introduction of the transfer records from April 3, 1970 through December 31, 1970 (Exhibit 64) and from January 5, 1971 through June 15, 1971 (Exhibit 65).

Mr. Bernhammer testified that it was impossible to tell from Exhibits 64 and 65 the underlying nature of the transaction which gave rise to the transfer. (R 731-732 1-19 to 1-4 R 736 1-9 to 1-19) The Bernhammer testimony does not prove any purchases or sales.

Lloyd Albin (R 759-769) testified that he purchased Microthermal shares at the time of the initial offering in 1969 and again in December of 1969. Albin also testified that he purchased 100 shares in November, 1970 which date does fall within the critical period but on cross examination he stated that he personally knew Morton Kaplan, the president of Microthermal and bought his shares after talking to Kaplan and being encouraged by Kaplan. (R 768-769).

Harrison Chapin (R 896-902) testified as an employee of Blythe, Eastman, Dillon, a broker and his testimony was used to introduce the monthly statements of one of their customers, Alfred A. Bertignole. [Exhibits 86, 86A and 86B). Although the statements showed purchases and sales in the later half of 1970 the witness testified that there was no way to tell from Exhibits 86, 86A and 86B the identity of the other party to the transaction or whether they reflected sales between members of the same family or from family trusts to members of the family. (R 898, 1-21)

Leon Segan (R 954-965) testified that he, his partner, mother and brother purchased Microthermal Shares in July, 1969 (Exhibits 85A, 85B, 85C and 85D). Segan neither bought nor sold any Microthernal Shares during 1970 or 1971. He continued to hold his Microthermal Shares through the time of the trial.

CONCLUSION

1. Section 10(b) and Rule 10b-5 are too uncertain to be penal statutes and Count Four should have been dismissed.

2. The Trial Court's instruction to the jury in relation to the phrase "in connection with the purchase or sale" was erroneous and Defendant should be granted a new trial.

3. Even accepting the Trial Court's instruction there was a failure of proof of purchases and sales of Microthermal shares and Defendant's motion for a directed verdict of acquittal should have been granted.

Respectfully submitted,

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Received 2 copies of the within
Appendix Appellant Roberts S. Persky's Brief
this 25 day of April, 1975.

Sign _____

For: Paul J. Curran Esq(s).

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